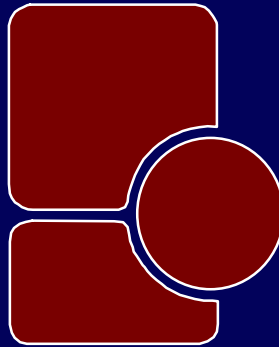


**Joint Legislative Audit and Review Commission
of the Virginia General Assembly**



**Review of the Virginia
Distribution Center**

**Staff Briefing
December 11, 2000**

Introduction

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Staff for this study:

Glen Tittermary, Division Chief

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Gerald Craver

Walt Smiley

Presentation Outline

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- ☒ **Study Overview and Summary of Findings**
 - ☐ **Background**
 - ☐ **State and Local Government Food and Housekeeping Product Requirements**
 - ☐ **Assessment of the State's Current Food and Housekeeping Product Procurement System**
 - ☐ **VDC Operational issues**

Study Mandate

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- Item 20 of the 2000 Appropriation Act directed JLARC to study the distribution of food and other products from the Virginia Distribution Center (VDC) to State and local government agencies.
- JLARC staff were required to review:
 - VDC's current operations and financing;
 - the adequacy of VDC's services and products;
 - alternatives for the distribution of food and housekeeping products to State and local government agencies, including the feasibility of privatizing distribution services; and
 - the feasibility of expanding VDC's services to local government agencies and nonprofit organizations in the State.

Research Activities

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- Interviews with staff at Department of General Services (DGS), Department of Corrections (DOC), Department of Mental Health, Mental Retardation and Substance Abuse Services (DMHMRSAS), universities, localities, federal agencies, and other states
- Site visits to eight DOC facilities, six DMHMRSAS facilities, four universities, two local government agencies, and two food distributors
- Mail survey of current VDC customers
- Mail survey of local government and non-profit organizations (not current VDC customers)
- Review of documents

Summary of Findings

6

- There are important differences across State agencies in terms of food and housekeeping product and service needs. These differences determine which product delivery system best meets the needs of each agency.
- VDC's products and services currently appear to meet the food and housekeeping product requirements of institutional organizations such as the DOC and DMHMRSAS in a cost-effective manner.

Summary of Findings

(continued)

7

- VDC does not appear to meet food product requirements of retail-oriented customers such as public universities. These agencies appear better served by a prime vendor.
- VDC faces some operational and financial challenges that it needs to address to remain viable. VDC's sales have been flat during the past few years while its expenses have increased. With the additional cost of the new warehouse, a rate adjustment, additional sales, and control of expenses appear needed.

Presentation Outline

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- ☐ Assessment of the State's Current Food and Housekeeping Product Procurement System
- ☐ VDC Operational issues

Procurement of Food and Housekeeping Products

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- State agencies purchase food and housekeeping supplies in four ways: VDC, DGS statewide contracts, and agency contracts and spot purchases from wholesale distributors and retail stores.
- State agencies are required to purchase supplies from the VDC, but it is an optional source of supplies for local government agencies.
- In addition, DOC requires its facilities to purchase meat, milk, and fresh produce from DOC's agribusiness operation.

Procurement of Food and Housekeeping Products (continued)

10

- If VDC is unable to provide supplies, State agencies may use term contracts and spot purchases to obtain food and housekeeping products from wholesale distributors and retail stores.
- State and local government agencies sometimes contract with one food and/or housekeeping distributor for the procurement of a majority of their supplies. Under this “prime vendor” arrangement, agencies purchase the majority of their food or housekeeping supplies from a specific distributor.

State Agency Expenditures for Food and Housekeeping Products

11

- State agencies spent approximately \$68.1 million on food and housekeeping products during FY 2000.
- State agencies purchased about \$32.8 million of these products from the VDC and \$5.9 million in meat, dairy, and fresh produce from DOC's agribusiness operation.

Overview of VDC

12

- VDC purchases high volume, standardized items for resale to State agencies and localities.
- VDC provides over 900 food and food-related items, paper products, and housekeeping supplies. VDC does not provide any perishable foods such as produce.
- VDC charges an eight percent mark-up on all goods sold to cover its direct and indirect expenses, including transportation costs.
- It is currently building a new warehouse, due to open in March 2001.

VDC Exterior View

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Inside a VDC Building

14



Braces Added to Support Roof

15



New VDC Warehouse Under Construction

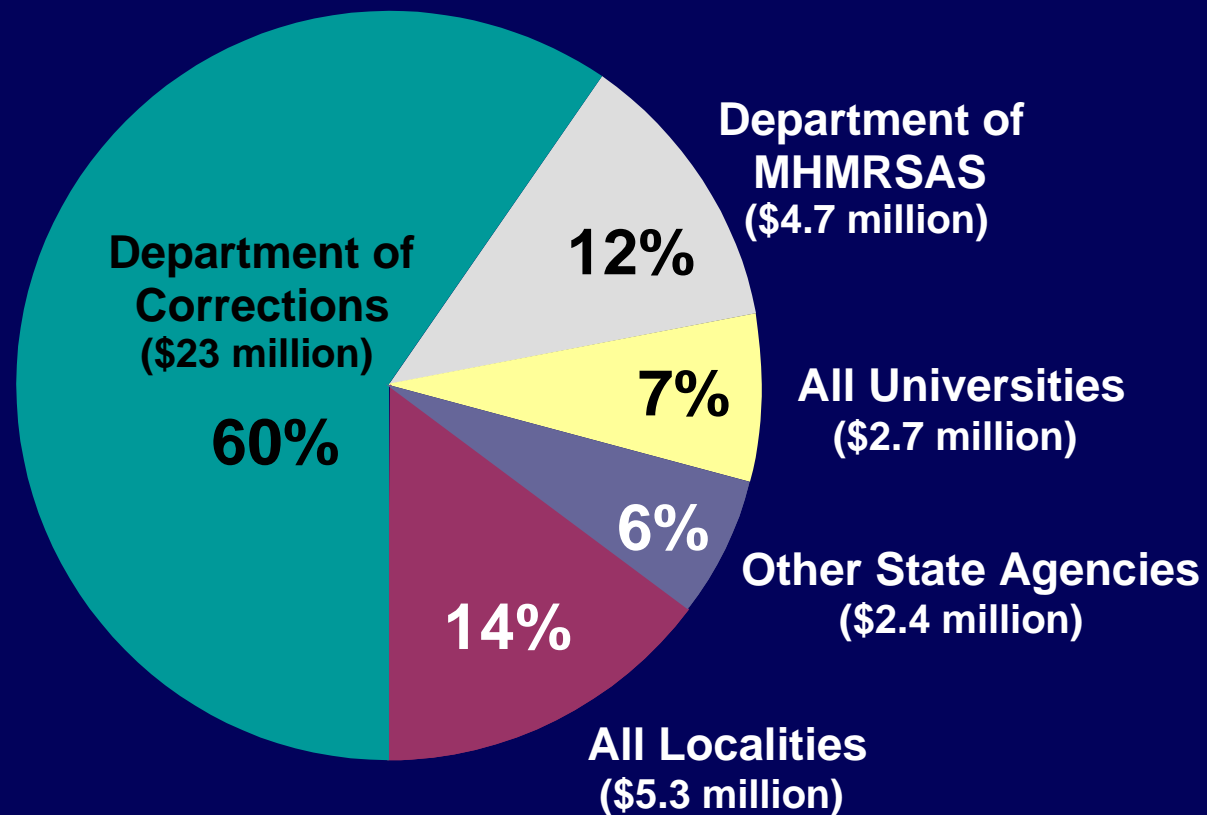
16



VDC's Customers

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VDC Sales, FY 2000



Total Sales: \$38.1 Million

Presentation Outline

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- ☐ VDC Operational issues

Correctional Facilities

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- DOC takes a “no-frills” approach to its food service program that reflects an emphasis on security and minimizing costs.
 - For example, DOC facilities do not require grade A or “branded” products.
- DOC is under budgetary pressure to keep food costs low, which it does in part through extensive use of inmate labor in food preparation and service.
- DOC uses a 28-day “master menu” that is intended to ensure the nutritional adequacy of the meals it serves to inmates while permitting economies through bulk ordering.

Correctional Facilities

(continued)

20

- Due to the security concern, DOC facility staff prefer to minimize the number of vendors and deliveries they deal with. They consider use of a warehouse for delivery drop-off to be an integral part of security.
- DOC facilities use the fewest food vendors (six on average including the VDC), and have the fewest deliveries per month (23 on average) of all VDC's customers. DOC facilities purchase on average about 90 percent of their food supplies from VDC (not including DOC agribusiness).
- DOC facilities typically use only one or two vendors for housekeeping products. On average, facilities purchase about 94 percent of their housekeeping supplies from the VDC.

Mental Health and Mental Retardation Facilities

21

- DMHMRSAS facilities operate institutional food service programs that use a 21-day menu based on a standard set of recipes.
- While there is a standardized menu, the varied physical and mental capabilities of the patients necessitate numerous modifications across the resident population.
- DMHMRSAS facilities use “cook-chill” technology and a computerized food management system to provide meals to patients based on their physical and dietary needs.

Mental Health and Mental Retardation Facilities

(continued)

22

- **Most DMHMRSAS facilities use several vendors (11 on average) to meet their food product needs.**
- **As with DOC, DMHMRSAS facilities do not typically need to buy grade A or “brand name” products since most food goes through extensive processing before final delivery to patients.**
- **Since implementing cook-chill technology, facilities purchase more pre-cooked food products (which they often must obtain through local distributors).**
- **DMHMRSAS facilities use only a few housekeeping supply vendors. Their primary source is VDC.**

Universities

23

- College and university food service operations are “auxiliary programs” supported through the sale of student meal plans and food products.
- They have evolved from cafeteria-style, single entrée dining facilities into large retail-type operations serving a wide variety of brand name food products.
- Currently, Radford University, Christopher Newport University (CNU), and Virginia Tech are the only three public universities that operate their own dining facilities. The other universities have outsourced their operation to a food service provider.

Virginia Tech Dining Facilities



Universities

(continued)

25

- The three universities with self-operated food services purchase a wide range of food products.
 - For example, Radford University purchased almost 2,000 different food and food-related products in FY 2000.
- Virginia Tech uses a prime vendor to obtain the majority of its food products.
- Radford and CNU purchase most of their food from a large number of vendors using a combination of agency term contracts and spot purchases. They purchase relatively little from the VDC.

Universities

(continued)

26

- All but two of the States' public colleges and universities manage their own housekeeping programs. (Longwood College and Virginia State University outsourced their housekeeping operations.)
- Most universities purchase the majority of their housekeeping supplies from the VDC.
- However, two universities -- Virginia Tech and UVA -- purchase the bulk of their housekeeping products from a prime vendor.

Other State Agency Users of Food Products

27

- Other State agencies have food service operations that can be classified as either “institutional” or “retail-oriented” depending on the type of clientele they serve and their source of funding.
- Institutional agencies, which cater to resident populations, use relatively few food vendors and receive few deliveries per month. They buy a majority of their food from the VDC.
- Agencies with retail-oriented dining facilities, which cater to a non-resident population, typically receive frequent deliveries from a large number of vendors. These organizations obtain most of their food supplies from wholesale distributors since the VDC does not stock the variety of products or provide the delivery service they require.

Local Government Users of Food and Housekeeping Products

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- Local school systems and local and regional jails purchase most of the food and housekeeping supplies that are consumed at the local level.
- Local school systems typically require frequent deliveries to each individual school, and they need access to grade A and brand name food products.
- As a result of these service and product requirements, few school systems purchase food and housekeeping products from the VDC, and instead rely on prime vendors or other local distributors.

Local Government Users of Food and Housekeeping Products

(continued)

29

- Local and regional jails purchase food products from a variety of sources. Most of the jails responding to the JLARC surveys use a combination of spot purchases and local term contracts to purchase their food products from wholesale distributors.
- In addition, 45 percent of the jails purchase at least some of their food products from the VDC.
- Jails which use VDC, on average, purchase a majority of their housekeeping products from the VDC.

Presentation Outline

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- ☒ **Assessment of the State's Current Food and Housekeeping Product Procurement System**
- ☐ VDC Operational issues

Framework for Assessing Food and Housekeeping Procurement Approaches

31

■ Product and service factors:

- types of products needed, including the range and quality level of those products
- frequency of delivery
- number of locations products are to be delivered

■ Cost factors:

- cost of products
- inventory carrying costs
- procurement staff time
- oversight of procurement sources

State Procurement Options

32

■ There are four broad options available:

- **Current approach**, in which VDC is the single largest source of food and housekeeping products, supplemented with State contracts and local purchases;
- **Prime vendor approach**, in which the majority of goods are purchased from one vendor, supplemented with other State contracts and local purchases;
- **State contract approach**, in which the majority of goods are purchased through a series of several State contracts;
- **“Free for all” approach**, in which each agency is responsible for procuring its own goods.

■ The first two options appear the most viable.























Assessment of Agency Procurement Approaches

33

- JLARC staff focused the assessment of procurement approaches on the use of VDC and the use of a prime vendor.
- Three primary questions guided the JLARC assessment:
 - Which approach provides the level of product quality needed?
 - Which approach provides the level of service needed?
 - What approach is the least costly, given the set of quality and service requirements?

Assessment of VDC's Ability to Meet Agencies' Product Needs

34

KEY:		 Meets Criterion Well	 Meets Criterion with Some Reservations	 Does Not Meet Criterion	 Unknown
FOOD PRODUCTS			DOC	DMHMRSAS	Universities
	Provides Products Needed				
	Provides Level of Service Needed				
	Provides Lowest Total Cost				 *
HOUSEKEEPING PRODUCTS			DOC	DMHMRSAS	Universities
	Provides Products Needed				
	Provides Level of Service Needed				
	Provides Lowest Total Cost				

* VDC product prices are typically lower than those of prime vendors. Universities have been able to reduce their total cost of operations through the use of prime vendors, primarily due to warehouse personnel reductions achievable with that approach.

Use of the VDC

35

- Since DOC is the largest State purchaser of food and accounts for almost two-thirds of VDC's sales, it is clearly a driving force in determining the products offered by the VDC.
 - Approximately 90 percent of DOC facilities' food product needs (in terms of expenditures) not met by its agribusiness operation are provided by VDC.
- Also, due to security concerns most DOC facilities want to minimize the frequency of deliveries, which is consistent with VDC's structure.

Use of the VDC (continued)

36

- While also generally meeting the needs of DMHMRSAS facilities, it is not quite as good a fit as with DOC facilities.
 - There are a number of food products that DMHMRSAS facilities must obtain through local sources, which reduces the efficiency of the system.
- VDC is reportedly examining the feasibility of adding items to its product line once it moves to the new warehouse.
- VDC has also been working with DMHMRSAS facilities to develop a schedule of weekly deliveries to the facilities.

Use of the VDC (continued)

37

- Data collected and examined during the course of this review suggests that the VDC sells its products to State and local agencies at a lower price than private sector vendors.
- VDC's annual market basket survey compares VDC's prices to local wholesale distributors across the State. The March 2000 survey found that VDC's prices for food and housekeeping products were an average of 41 percent and 40 percent lower, respectively, than the local distributors.

Use of the VDC (continued)

38

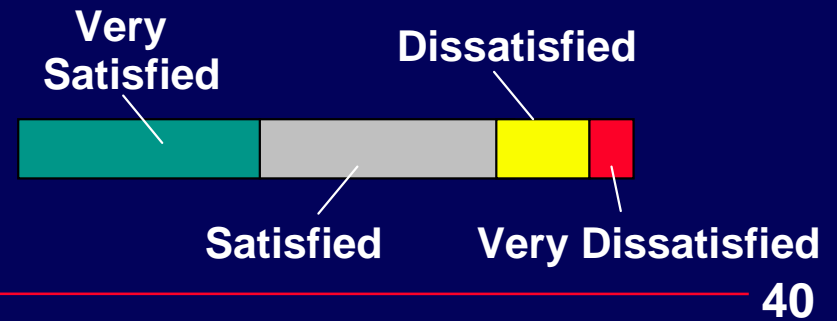
- In 1998, the College of William and Mary Compete Center conducted a market basket survey as part of its study of the State's food delivery system.
 - Based on agencies' monthly usage of a sample of products, it found that VDC's prices were 17 percent lower than the private vendor that submitted price quotes.
- JLARC staff also conducted a market basket survey, comparing VDC's prices to various wholesale distributors that serve as prime vendors for the State and federal government.
 - This comparison showed that DOC and DMHMRSAS facilities would have paid from 13 percent to 41 percent more to the prime vendors compared to the VDC.

Use of the VDC (continued)

39

- VDC does not adequately meet the food procurement needs of CNU, Radford University, and Virginia Tech.
- VDC does not offer the range of food products needed by these universities, nor does it provide the delivery frequency needed.
- In contrast, most universities with their own housekeeping operations reported satisfaction with the product and service levels provided by VDC.
- While VDC product prices are typically lower than prime vendors, universities have been able to reduce their total cost of operation using prime vendors, primarily due to warehouse personnel reductions.

Agency Views of VDC's Food Products & Services



“Quality of VDC’s food and food-related products”



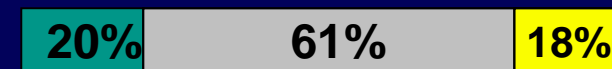
“Cost of VDC’s food and food-related products”



“Timeliness of VDC’s product deliveries”



“VDC’s ability to deliver the correct amount and type of products ordered”



“Variety of products offered by the VDC”



“Overall quality of VDC’s service”



Agency Views of VDC's Housekeeping Products



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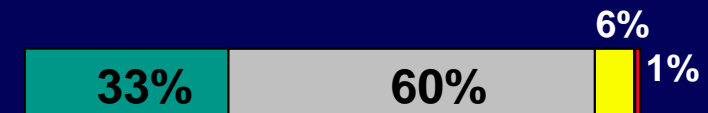
“Quality of VDC’s housekeeping products”



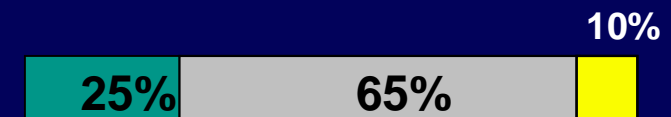
“Cost of VDC’s housekeeping products”



“Timeliness of VDC’s product deliveries”



“VDC’s ability to deliver the correct amount and type of products ordered”



“Variety of products offered by the VDC”



“Overall quality of VDC’s service”



Use of a Prime Vendor


42

- There are three variations on the prime vendor approach that the State could adopt:
 - have one prime vendor responsible for supplying all State agencies;
 - divide the State into geographic regions and have one prime vendor contract for each region;
 - develop prime vendor contracts for individual agencies or small groups of agencies on a case-by-case basis.
- The third option is currently in limited use across the State, primarily at the local government level.

Assessment of Prime Vendors' Ability to Meet Agencies' Product Needs

43

KEY:  Meets Criterion Well  Meets Criterion with Some Reservations  Does Not Meet Criterion  Unknown

		DOC	DMHMRSAS	Universities
FOOD PRODUCTS	Provides Products Needed			
	Provides Level of Service Needed			
	Provides Lowest Total Cost			

		DOC	DMHMRSAS	Universities
HOUSEKEEPING PRODUCTS	Provides Products Needed			
	Provides Level of Service Needed			
	Provides Lowest Total Cost			

Use of a Prime Vendor (continued)

44

- It appears that there are two main strengths to the prime vendor approach:
 - Prime vendors offer a wide assortment of products, including “branded” products and those of various grades. This allows customers to buy the majority of their products from one source, saving on procurement effort.
 - Prime vendors typically provide frequent deliveries (for example, several times a week), which is critical for customers with limited storage capacity.

Use of a Prime Vendor (continued)

45

- The strengths of the prime vendor approach directly address the product and service needs of the State's universities.
 - Universities use a large number of food and food-related products, including grade A and branded products. They also need consistency in the products supplied.
 - The universities also reported needing relatively frequent deliveries for their food service operations.
- Virginia Tech reported being very satisfied with its prime vendor arrangement for food.

Use of a Prime Vendor (continued)

46

- Evidence suggests that the primary financial benefit obtained from a prime vendor approach comes from the ability to eliminate an agency's warehouse and accompanying personnel by having the vendor deliver directly to kitchen facilities on a frequent basis.
- Some financial benefit could also result if use of a prime vendor enabled an agency to reduce its procurement effort (for example, the number of vendors it routinely uses and the number of contracts maintained).

Use of a Prime Vendor (continued)

47

- **Virginia Tech's prime vendor provides daily food deliveries directly to its dining facilities. As a result, Virginia Tech's staff are no longer responsible for receiving food products at a central warehouse and then redelivering them to dining facilities. Staff reported a net savings of \$300,000 by eliminating salary and operational expenses associated with its central food warehouse.**
- **Use of a prime vendor also resulted in a reduction of deliveries, which subsequently reduced the number of invoices and related documents that they had to process.**
 - **Virginia Tech now receives 104 deliveries per month from an average of ten vendors -- substantially less than the other universities.**

Use of a Prime Vendor (continued)

48

- In contrast, the food procurement approaches for Radford University and CNU appear inefficient.
 - Rely on more than twice as many vendors as the other State groups, purchasing food from an average of 28 vendors per month and receiving an average of 210 food deliveries per month
 - Rely extensively on term contracts of relatively short duration as well as spot purchasing, which require a substantial amount of procurement effort
- These universities should be able to reduce the number of vendors used and number of deliveries received by use of a prime vendor for a majority of food products.

Use of a Prime Vendor (continued)

49

- It does not appear that similar benefits would accrue to Virginia's DOC and DMHMRSAS facilities if they switched to a prime vendor approach.
 - First, DMHMRSAS facilities are phasing out the use of warehouses for food storage under the VDC procurement approach, and therefore there would be no additional savings to be derived.
 - DOC facilities reported a need for their warehouses for security purposes; therefore, it does not appear feasible to close those warehouses at this time.
 - Virginia has already taken steps to reduce the inventory levels of DOC and DMHMRSAS facilities -- a source of one-time savings.
 - DOC and DMHMRSAS facilities generally do not use a large number of vendors; their procurement process is fairly streamlined.

State's Procurement Approach

50

- Given that different approaches work best for different customers, it does not appear beneficial for the State to select one procurement approach for the entire State.
- While there may be some cost advantage to consolidating the buying power of DOC, DMHMRSAS, the universities, and others to obtain better prices, the substantially different service needs of customers suggest that certain customers, such as the universities, may be helped at the expense of other customers. In other words, some customers may end up paying for services that they do not want or need.

Procurement Changes Needed

51

- It appears that Radford and CNU should develop prime vendor contracts that would enable them to buy the majority of food from one source.
- To enable them to pursue a prime vendor approach, DGS should amend its mandatory source rule to allow agencies with retail-oriented operations to obtain products in a manner that allows for the least overall cost to the agency.
- Universities that currently use warehouses to store housekeeping products should assess whether it would be feasible and cost-effective to eliminate their warehouses and develop prime vendor contracts.

Recommendations

52

- The Department of General Services should amend its mandatory source rule to allow agencies with retail-oriented operations to obtain their food from the source that provides the service level needed at the lowest total cost.
- Universities that currently use warehouses to store housekeeping products should conduct an assessment to determine whether it would be feasible and cost-effective to eliminate their warehouses and develop prime vendor contracts that support “desktop” delivery of products on a frequent basis. Such an assessment should include determining whether the warehouse can be used for other needed purposes, and whether the savings associated with closing the warehouse would offset any cost increases in product prices from use of a prime vendor. The Department of General Services should exempt from the mandatory source rule any university that identifies a savings through the use of an alternative procurement approach, such as prime vending.

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VDC Generally Follows Sound Warehouse Practices

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- VDC currently uses or is in the planning phase to implement a number of model management practices for distribution centers, including:
 - web page for customers to obtain up-to-date information about product offerings and prices and to submit orders on-line
 - cycle-based counting of inventory
 - warehouse management computer system
 - radio-frequency bar code scanning of products
 - use of customer product advisory committees
 - cross-docking of fast-moving inventory

VDC Faces Operational Challenges

55

- There are a number of operational problems that VDC needs to address:
 - VDC lacks adequate management reports readily available for decision making purposes
 - VDC needs to reduce the amount of time necessary to fill orders
 - VDC does not always communicate well with customers regarding individual orders
 - VDC needs to reduce its inventory level

Recommendations

56

- DGS should develop the management reports necessary for sound decision-making as soon as possible.
- DGS should ensure that VDC staff receive training on report development for an Oracle-based system.
- VDC should set an organization-wide objective of filling orders not later than six working days after receipt of an order or on the customer's requested delivery date, whichever is later.
- VDC should take measures to ensure that notification of customers regarding problems with their orders takes priority. VDC should institute the use of advance shipping notices, which is a feature available through its new computer system.
- VDC should develop and use fill rate reports to identify what products, if any, VDC is having trouble keeping in stock, and take appropriate steps to prevent future stock-out problems.

VDC's Financial Performance

57

- Over the past five years, VDC has generated small profits in three years and small losses in two years, which is consistent with a program intended only to cover its costs and not generate significant earnings.
- Since FY 1996, VDC sales have been level, fluctuating between \$38 and \$41 million per year. VDC's operating costs have climbed over the same period from \$2.4 million (6.0 percent sales) in FY 1996, to \$3.8 million (9.9 percent sales) in FY 2000.
- Most of the increase in VDC operating expenses has resulted from increases in freight costs, employee compensation, and computer-related initiatives.

VDC's New Warehouse

58

- VDC has also started paying for the construction of its new warehouse.
 - The warehouse is estimated to cost \$12.5 million and is expected to open in the spring of 2001.
 - Key reasons for the new warehouse were to avoid the physical limitations and high costs of either renovating or continuing to maintain the old warehouse facility, to provide space to accommodate growth, to improve operating efficiency, and to have the ability to stock additional types of commodities.
- The 1997 General Assembly authorized DGS to use a Treasury loan to pay for the construction. The agency may take as long as 12 years to repay the loan.

VDC Needs to Address Operating Losses

59

- Increasing expenses and a fixed mark-up of eight percent have led to losses for the VDC in the last two years.
- Because VDC must cover its expenses, including the cost of the new warehouse, it appears necessary to re-examine the mark-up allowed on VDC products. Factors to consider include the length of time to be used to pay off the Treasury loan and the impact of any cost increase on VDC's customers.

VDC Needs to Address Operating Losses (continued)

60

- **VDC also needs to focus attention on increasing its customer base. Currently, VDC conducts very little marketing to promote increased use of the VDC.**
- **There appear to be two main targets that the VDC should pursue:**
 - **It appears that local and regional jails maintain the type of operation that can be adequately met by the VDC. Currently, only five of the 20 regional jails buy from the VDC.**
 - **State procurement rules allow a private firm to purchase supplies from the VDC as long as those supplies are used on behalf of a State agency. DGS should explore this option with the service providers with which it has contracts for State office buildings and encourage other agencies to do the same.**

Recommendations

61

- DGS should complete its assessment of options for eliminating VDC's operating loss, including possible adjustments to the VDC mark-up rate. Any proposed rate adjustment should clearly indicate the intended pay-off period for the Treasury loan. DGS should report on its assessment to JLARC by May 2001.
- VDC should develop a marketing plan geared toward adding new State and local agencies to its customer base. Implementation of the plan should begin as soon as it moves to the new warehouse in the spring of 2001.